Objectives of Taxation

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- In a market economy, taxes are imposed to provide funds to enable the government to undertake the following responsibilities:

➢ **Provision of Public Goods:**

The pure public goods have the following features:

1- The marginal cost of providing public good is equal to zero.

2- The exclusion principle cannot be applied

3- All members of society must consume the same amount of the public good.

- Since there is no compulsory payment for public goods, the government imposes taxes to finance the provision of public goods.

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➢ Ensuring Economic Stability:

- The government is responsible for ensuring economic stability that can be achieved through:

1- Reasonable degree of price stability.

2- High employment.

3- Improve in the balance of payments situation.

4- Acceptable rate of economic growth.

The tax system is a powerful method of influencing the level of activity that achieves the above components of economic stability.

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➢ **Helping in its Economic Development Process:**

- Taxation policy is usually used to reallocate resources to the efficient use, reduce consumption and increase saving and investment to achieve economic development.

➢ **Achieving Equitable Distribution of Income and Wealth:**

- Taxation is used to redistribute income in the economy.
- The taxation policy is widely used to transfer the purchasing power from one group to another to make the distribution of income and wealth fair and just.

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➢Promotion of Social and Economic Welfare:

- The government takes a very important role by providing merit goods (goods with positive externalities such as health and education).
- On the other hand, the government discourages the production of demerit goods (goods with negative externalities such as alcohol and cigarettes) to reduce their external costs to the society.

The principle of an Ideal Tax

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- Adam Smith proposed that a good tax should display the following features:

1. It should reflect a person's ability to pay (equity) .
2. It should be convenient with respect to the timing and manner of payment.
3. It should be certain (certainty).
4. It should be administratively efficient and not causing economic distortion (efficiency) .

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- In a modern tax system, an ideal tax should satisfy the following criteria:

1- Simple, Certain, and convenient:

The tax should be relatively simple for taxpayers to understand their liability and the method of payment should be convenient.

2- Flexible:

The structure and the tax rate should be capable of being changed without too much difficulty.

The principle of an Ideal Tax

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3-Administratively Efficient:

The costs of administrating the tax should not be too high.

4- Neutral:

A tax is said to be neutral if it does not distort economic choices. This distortion is known as the excess burden of taxation that causes economic inefficiency.

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5- Equitable:

- Equity is concerned with the distribution of the tax burden. There are two types of equity to be considered:

A. Horizontal equity which requires that people in similar situations are treated in the same way and pay the same tax.

B. Vertical equity which requires that people in unequal situations are treated with the necessary degree of inequality in paying taxes. This requires the rich to pay more than the poor in a progressive system of taxation.

Requirements for a Good Tax Structure

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- The following are the requirements of a good tax structure:

1. Tax collections should be adequate.
2. The distribution of tax burden should be equitable.
3. Taxes should be chosen to minimize interference with economic decisions.
4. The tax structure should facilitate the use of fiscal policy for stabilization and growth objectives.
5. The tax system should be fair to taxpayers.
6. Administrative and compliance costs should be low.

Thank You

For good listening

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